

Revised Discussion Draft for Proposed Regulation Section 25136

§ 25136. Sales Factor. Sales Other than Sales of Tangible Personal Property in this State.

(a) In General. Sales other than those described under Revenue and Taxation Code Section 25136 are in this state if the taxpayer's market for the sales is in this state.

(b) General Definitions.

(1) "Benefit of a service is received" means the location where the taxpayer's customer has either directly or indirectly received value from delivery of that service.

Examples:

- (A) Real Estate Development Corp with its commercial domicile in State A is developing a tract of land in this state. Real Estate Development Corp contracts with Surveying Corp from State B to survey the tract of land in this state. Regardless of where the survey work is conducted, where the plats are drawn, or where the plats are delivered, the recipient of the service, Real Estate Development Corp, received all of the benefit of the service in this state.
- (B) Builder Corp with its commercial domicile in State A is building an office complex in this state. Builder Corp contracts with Engineering Corp from State B to oversee construction of the buildings on the site. Engineering Corp performs some of its service in this state at the building site and additional service in State B. Because all of Engineering Corp's services were related to a construction project in this state, the recipient of the services, Builder Corp, received all of the benefit of the service in this state.
- (C) General Corp with its commercial domicile in State A contracts with Computer Software Corp from State B to develop and install custom computer software for General Corp. The software will be used by General Corp in a business office in this state and in a business office in State A. The software development occurs in State B. The recipient of the service, General Corp, received the benefit of the service in both State A and in this state.
- (D) Apartment Corp owns 100 apartments in this state and 400 apartments in State A, and contracts with Pest Control Corp for pest control services. The benefit of the service is received in both State A and in this state.

(2) "Service" means a commodity consisting of activities engaged in by a person for

another person for consideration. The term “service” does not include activities performed by a person who is not in a regular trade or business offering its services to the public, and does not include services rendered to a member of an affiliated group by another member of the same affiliated group that does not sell to the public the type of service provided to its affiliate.

- (3) "Cannot be determined" means that the taxpayer's records or the records of the taxpayer's customer which are available to the taxpayer do not indicate the location where the benefit of the service was received or where the intangible property was used.
- (4) “Commercial domicile” means the principal place from which the trade or business of the taxpayer is directed or managed.
- (5) "Intangible property" includes but is not limited to patents, copyrights, trademarks, service marks, trade names, licenses, plans, specifications, blueprints, processes, techniques, formulas, designs, layouts, patterns, drawings, manuals, trade secrets, stock, contract rights including broadcasting rights, and other similar intangible assets.
  - (A) A "marketing intangible" includes, but is not limited to, the license of a copyright, service mark, trademark, or trade name where the value lies predominantly in the marketing of the intangible property in connection with goods, services or other items.
  - (B) A "non-marketing and manufacturing intangible" includes, but is not limited to, the license of a patent, a copyright, or trade secrets to be used in a manufacturing process, where the value of the intangible lies predominately in its use in such process.
  - (C) A "mixed intangible" is where a license of intangible property includes both a license of a marketing intangible and a license of a non-marketing intangible.
- (6) "Intangible personal property is used" means the location where the intangible property is employed by the taxpayer's customer or licensee.
- (7) "Reasonably approximated" means that, considering all sources of information other than the terms of the contract and the taxpayer's books and records kept in the normal course of business, the location of the market for the benefit of the services or the location of the use of the intangible property is determined in a manner that is consistent with the business of the customer. Information, including publicly available information such as population, that is specific in nature, is preferred over information that is general in nature.

- (8) "To the extent" means that if the customer of a service receives the benefit of a service or uses intangible property in more than one state, the gross receipts from the performance of the service or the sale of intangible property are included in the numerator of the sales factor according to the portion of the benefit of the services received and/or the use of the intangible property in this state.
- (c) Sales from services are assigned to this state to the extent the customer of the taxpayer receives the benefit of the service in this state.
- (1) In the case where an individual is the taxpayer's customer, the benefit of the service shall be determined to be received in this state as follows:
- (A) The billing address of the taxpayer's customer shall be presumed to be the location (or locations) where the benefit of the service is received. This presumption may be overcome by the taxpayer or the Franchise Tax Board by evidence showing that the benefit of the service was not received at the billing address. If the presumption is overcome, then the contract between the taxpayer and the taxpayer's customer or other books and records of the taxpayer kept in the normal course of business shall be presumed to provide the extent to which the service is performed at a location (or locations) in this state under subparagraph (B).
- (B) If the location (or locations) where the benefit of the service is received cannot be determined under subparagraph (A), then the contract between the taxpayer and the taxpayer's customer or the taxpayer's books and records kept in the normal course of business shall be presumed to provide the extent to which the service is received at a location (or locations) in this state. This presumption may be overcome by the taxpayer or the Franchise Tax Board upon an evidentiary showing that the location (or locations) where the benefit of the service was received was not the location (or locations) of the receipt of the benefit of the service provided for in the contract or the taxpayer's books and records. If the presumption is overcome, then the location (or locations) of the receipt of the benefit of the services shall be reasonably approximated under subparagraph (C).
- (C) If the location (or locations) where the benefit of the service is received cannot be determined pursuant to subparagraphs (A) or (B), then the location where the benefit of the services is received shall be reasonably approximated by reference to the activities of the customer.
- (D) Examples.
1. TV Corp provides cable television and telecommunications services to individuals in this state and other states for a monthly fee billed to the

customer's address. Gross receipts from these services are assigned to this state if the billing address of the customer is in this state.

2. Software Tech Support Corp located in this state provides technical support services to its customers, who are individuals located throughout the United States, through a call center located in this state.
  - A. Software Tech Support Corp's contract with its customers indicate that fifteen percent of its customers are located in this state. Fifteen percent of the receipts from providing technical support services are in this state. However, Software Tech Support Corp's books and records, maintained in the regular course of business, indicate that seven (7) percent of the calls handled by the call center originate from this state. Because Software Tech Support Corp's books and records show where the benefit of the services is actually received and that the contract provisions are less accurate, seven (7) percent of the gross receipts from the support services provided by the call center are in this state.
  - B. If neither Software Tech Support Corp's contract with its customer nor its books and records indicate where the benefit of the service is received, then the customer's billing address shall be presumed to be the location where the benefit of the services was received.
  - C. Same facts as (b) above except that the presumption that the customers' billing address is where the benefit of the service is received is overcome. Sales can be assigned by reasonable approximation using population data by a ratio of population where Software Tech Support Corp provides its services everywhere as compared to California's population where Software Tech Support Corp provides its services.
- (2) In the case where a corporation or other business entity is the taxpayer's customer, the benefit of the service shall be determined to be received in this state as follows:
  - (A) The contract between the taxpayer and the taxpayer's customer or the taxpayer's books and records (exclusive of the billing address of the taxpayer's customer) kept in the normal course of business shall be presumed to provide the location (or locations) where the benefit of the services is received. This presumption may be overcome by the taxpayer or the Franchise Tax Board upon an evidentiary showing that the location (or locations) where the benefit of the service was received was not the location where the benefit of the service was received as provided for in the contract

or the taxpayer's books and records (exclusive of the billing address) kept in the normal course of business. If the presumption is overcome, then the location (or locations) where the benefit is received shall be reasonably approximated under subparagraph (B).

- (B) If the location where the service is received cannot be determined under subparagraph (A), then it shall be reasonably approximated by reference to the activities of the taxpayer's customer to the extent such information is available to the taxpayer. If the location of where the service is received cannot be reasonably approximated, then it shall be presumed to be the location from which the taxpayer's customer placed the order for service under subparagraph (C).
- (C) If the location where the benefit of the service is received cannot be determined under subparagraph (A) or reasonably approximated under subparagraph (B), then the location where the benefit of the service is received shall be presumed to be the location from which the taxpayer's customer placed the order for the service.
- (D) If the location where the benefit of the service is received cannot be determined pursuant to subparagraphs (A), (B), and (C), then the benefit of the service shall be in this state if the taxpayer's customer's billing address is in this state.
- (E) Examples.
  - 1. Payroll Services Corp contracts with Customer Corp to provide all payroll services. Customer Corp is commercially domiciled in this state and has employees in a number of other states. The contract between Payroll Services Corp and Customer Corp does not specify where the service will be used by Customer Corp. Payroll Services Corp's books and records which are kept in the normal course of business indicate that Customer Corp's central payroll department is located in this state and accesses the website of Payroll Services Corp to distribute payroll to all of its locations. All gross receipts from the payroll services provided to Customer Corp will be assigned to this state as the benefit of the service is received by Customer Corp customer at its central payroll facility.
  - 2. Law Corp located in State C has a Client Corp that has manufacturing plants in this state and State B. Law Corp handles a major litigation matter for Client Corp concerning a manufacturing plant owned by its client in this state. All gross receipts from Law Corp's services related to the litigation are attributable to this state because Law Corp's books and records kept in the normal course of business indicate that the services relate to Client Corp's operations in this state.

3. Audit Corp located in this state provides accounting, attest, consulting, and tax services for Client Corp. The contract between Audit Corp and Client Corp provides that Audit Corp is to audit Client Corp for tax year ended 20XX. Client Corp's books and records kept in the normal course of business, internal controls and assets are located in States A, B and this state. As a result, Audit Corp's staff will perform the audit activities in States A, B and this state. Audit Corp's business books and records track hours worked by location where its employees performed their service. Audit Corp's receipts are attributable to this state and States A and B according to the taxpayer's books and records which indicate time spent in each state by each staff member.
4. Web Corp provides internet content to its viewers and receives revenue from providing advertising services to other businesses. Web Corp's contracts with other businesses do not indicate the location (or locations) where the benefit of the service is received. The advertisements are shown via the website to Web Corp viewers and the fee collected is determined by reference to the number of times the advertisement is viewed and/or clicked on by viewers of the website.
  - A. If Web Corp through its books and records kept in the normal course of business can determine the location from which the advertisement is viewed and/or clicked on by viewers of the website, then gross receipts from the advertising will be assigned to this state by a ratio of the number of viewings and/or clicks of the advertisement in this state to the total number of viewings and/or clicks on the advertisement.
  - B. If Web Corp cannot determine the location from which the advertisement is viewed and/or clicked on through its books and records, it shall reasonably approximate the location of the receipt of the benefit by assigning its gross receipts from advertising by a ratio of the number of its viewers in this state to the number of its subscribers everywhere.
5. For a flat fee, Painting Corp contracts with Western Corp to paint Western Corp's various sized buildings located in this state and four (4) other states. The contract does not break down the cost of the painting per building or per state. Painting Corp's books and records kept in the normal course of business indicate the location of the buildings that are to be painted but do not provide any method for determining the extent that the benefit of the service is received in this state, i.e. the size or number of buildings to be painted at each location.

- A. Since neither the contract nor Painting Corp's books and records indicate how much of the fee is attributable to this state and there is no method of reasonably approximating the location of where the benefit of the service is received, the sale will be assigned to this state if the order for the service was placed from this state.
  - B. If the sale cannot be assigned under subparagraph a., then the sale shall be assigned to this state if Western Corp's billing address is in this state.
- (d) Sales from intangible property are assigned to this state to the extent the property is used in this state.
  - (1) In the case of the complete transfer of all property rights in intangible property as defined in subsection (b)(5) for a jurisdiction or jurisdictions, the use of intangible property in this state shall be determined as follows:
    - (A) The extent that the intangible property is used in this state shall be determined by the use of the intangible property by the taxpayer prior to the time of the purchase of the intangible property. It shall be presumed that the contract between the taxpayer and the purchaser or the taxpayer's books and records kept in the normal course of business provide where the purchaser will use the intangible at the time of purchase. This presumption may be overcome by the taxpayer or the Franchise Tax Board by evidence showing that the purchaser's use of the intangible at the time of purchase is not as set forth in the contract or the taxpayer's books and records. If the presumption is overcome, then the location of the use of the intangible property shall be reasonably approximated under subparagraph (B).
    - (B) If the extent of the use of the intangible property in this state cannot be determined under subparagraph (A), it shall be reasonably approximated by reference to the activities of the purchaser, as limited by the jurisdiction or jurisdictions to which the transfer applies, to the extent such information is available to the taxpayer.
    - (C) If the extent of the use of the intangible property in this state cannot be determined pursuant to subparagraphs (A) or (B), then the gross receipt shall be assigned to the billing address of the purchaser.
    - (D) Example. Farm Auction Corp purchases all of the stock of Cattleman Auction Corp from its parent, World Auction Corp. Cattleman holds auctions in this state and State A and State B. As of the date of the purchase, tax year ended 20XX, there have been (10) auctions in this state, and five (5) auctions each in both State A and in State B. World Auction Corp's receipts from its sale of its stock in Cattleman Auction Corp are assigned by



multiplying the amount of the gross receipts by the percentage this state's total auctions (ten (10)) represents as compared to total auctions in all states (twenty (20)), which would be fifty (50) percent in this example.

- (2) In the case of the licensing, leasing, rental or other use of intangible property as defined in subsection (b)(5), not including sales of intangible property provided for in paragraph (1), the use of intangible property in this state shall be determined as follows:

(A) Marketing intangibles.

1. Where a license is granted for the right to use intangible property in connection with the sale, lease, license, or other marketing of goods, services, or other items, the royalties or other licensing fees paid by the licensee for such right are attributable to this state to the extent that the fees are attributable to the sale or other provision of goods, services, or other items purchased or otherwise acquired by this state's customers, as is provided for by the terms of the contract between the taxpayer and the licensee of the intangible property or the taxpayer's books and records kept in the normal course of business. If the contract or the taxpayer's books and records provide a method for determination of this state's customers for the purchase of goods, services, or other items in connection with the use of the intangible property, then the contract's terms or the taxpayer's books and records will be presumed to properly indicate this state's customers for the purchase of goods, services, or other items in connection with the use of the intangible property. This presumption may be overcome by the taxpayer or the Franchise Tax Board upon an evidentiary showing that a method for determination of this state's customers is not set forth in the contract between the taxpayer and the licensee or the taxpayer's books and records. If the presumption is overcome, then the location of the use of the intangible property shall be reasonably approximated under subparagraph 2.
2. If the location of the use of the intangible property is not determinable under subparagraph 1, the location of the use of the intangible property shall be reasonably approximated by reference to the activities of the taxpayer's customer to the extent such information is available to the taxpayer. Reasonable approximation of the location of the use of the intangible property includes but is not limited to the percentage of this state's population as compared with the total population of the geographic area in which the licensee uses the intangible property to market its goods, services or other items to the extent such information is available to the taxpayer.



3. Where the license of a marketing intangible is for the right to use the intangible property in connection with sales or other transfers at wholesale rather than directly to retail customers, the licensing fee will be attributed to this state based upon the percentage of this state's population as compared with the total population of the geographic area in which the licensee uses the intangible property to market its goods, services or other items to the extent such information is available to the taxpayer.

(B) Non-marketing and manufacturing intangibles.

1. Where a license is granted for the right to use intangible property other than in connection with the sale, lease, license, or other marketing of goods, services, or other items, the licensing fees paid by the licensee for such right are attributable to this state to the extent that the use for which the fees are paid takes place in this state, as is provided for by the terms of the contract between the taxpayer and the licensee of the intangible property or the taxpayer's books and records kept in the normal course of business. If the contract or the taxpayer's books and records provide a method for determination of the extent of the use of the intangible property in this state, then the contract's terms or the taxpayer's books and records will be presumed to properly indicate the extent of the use of the intangible property in this state. This presumption may be overcome by the taxpayer or the Franchise Tax Board upon an evidentiary showing that a method for determination of the extent of the use of the intangible property in this state is not set forth in the contract between the taxpayer and the licensee or the taxpayer's books and records. If the presumption is overcome, then the location of the use of the intangible property shall be reasonably approximated under subparagraph 2.
2. If the location of the use of the intangible property for which the fees are paid cannot be determined under subparagraph 1, then the location of the use of the intangible property shall be reasonably approximated by reference to the activities of the taxpayer's customer to the extent such information is available to the taxpayer.
3. If the location of the use of the intangible property for which the fees are paid cannot be determined under subparagraphs 1 or 2, it shall be presumed that the use of the intangible property takes place in the state of the licensee's billing address.

(C) Mixed Intangibles.

1. Where the fees to be paid in each instance are separately stated in the licensing contract, the Franchise Tax Board will accept such separate

statement for purposes of this section if it is reasonable. If the Franchise Tax Board determines that the separate statement is not reasonable, then the Franchise Tax Board may assign the fees in a reasonable method that accurately reflects the licensing of a marketing intangible and the licensing of a non-marketing intangible.

2. Where a license of intangible property includes both a license of a marketing intangible and a license of a non-marketing intangible and the fees to be paid in each instance are not separately stated in the contract, it shall be presumed that the licensing fees are paid entirely for the license of the marketing intangible, except to the extent that the taxpayer or the Franchise Tax Board can reasonably establish otherwise.

(D) Examples.

1. **Marketing Intangible.** Crayon Corp and Dealer Corp enter into a license agreement whereby Dealer Corp as licensee is permitted to use trademarks that are owned by Crayon Corp in connection with Dealer Corp's sale of certain products to retail customers. Under the contract, Dealer Corp is required to pay Crayon Corp a licensing fee that is a fixed percentage of the total volume of monthly sales made by Dealer Corp of products using the Crayon Corp trademarks. Under the agreement, Dealer Corp is permitted to sell the products at multiple store locations, including store locations that are both within and without this state. The licensing fees that are paid by Dealer Corp are broken out on a per-store basis. The licensing fees paid to Crayon Corp by Dealer Corp represent fees from the license of a marketing intangible and the fees that derive from the individual sales at stores in this state constitute sales in this state.
2. **Marketing Intangible.** Team Corp operates a professional wrestling team and licenses the annual rights to broadcast the team's games to a national television network, TV Corp, a regional cable TV company, Cable Corp, and a local radio station, Radio Corp. TV Corp, Cable Corp and Radio Corp send personnel to the site of Team Corp's games, both within and without this state, and broadcast these games on their respective media outlets. In each case the licensing fee paid by the media company to Team Corp is paid upfront in a lump sum. Each of the three licensing contracts constitutes the license of a marketing intangible. The component of the three licensing streams that constitute the sales in this state of Team Corp is determined by multiplying in each case the amount of the income stream by the percentage of this state's audience of the respective licensee that is in this state.

3. **Marketing Intangible.** Moniker Corp enters into a license agreement with Whole Corp, pursuant to which Whole Corp is granted the right to use trademarks owned by Moniker Corp to brand sports equipment that is to be manufactured by Whole Corp or an unrelated entity, and to sell the manufactured product to unrelated companies that make retail sales in a specified geographic region. Although the trademarks in question will be affixed to the tangible property to be manufactured, the license agreement confers a license of a marketing intangible. The component of the licensing fee that constitutes sales of Moniker Corp in this state is determined by multiplying the amount of the fee by the percentage of this state's population in the specified geographic region in which the retail sales are made.
4. **Non-marketing Intangible.** Formula Corp and Appliance Corp enter into a license agreement whereby Appliance Corp is permitted to use a patent owned by Formula Corp to manufacture and sell appliances at stores owned by Appliance Corp within a certain geographic region. The license agreement specifies that Appliance Corp is to pay Formula Corp a royalty equal to a fixed percentage of the gross receipts from the products sold. The contract does not specify any other fees. The appliances are manufactured and sold in this state and several other states. Given these facts, it is presumed that the licensing fees are paid for the license of a manufacturing intangible. Since Formula Corp can demonstrate the percentage of manufacturing by Appliance Corp that takes place in this state using the patent, that percentage of the total licensing fee paid to Formula Corp under the contract will constitute Formula Corp's sales in this state.
5. **Mixed Intangible.** Axel Corp enters into a two-year license agreement with Biker Corp in which Biker Corp is granted the right to produce motor scooters using patented technology owned by Axel Corp, and also to sell such scooters by marketing the fact that the scooters were manufactured using the special technology. The scooters are manufactured outside this state, but the taxpayer is granted the right to sell the scooters in a geographic area in which this state's population constitutes 25% of the total population during the period in question. The licensing agreement requires an upfront licensing fee to be paid by Biker Corp to Axel Corp but does not specify what percentage of the fee derives from Biker Corp's right to use Axel Corp's patented technology. Unless either the taxpayer or the Franchise Tax Board reasonably establishes otherwise, it is presumed that the licensing fees are paid entirely for the license of a marketing intangible. In such cases, it will be presumed that 25% of the licensing fee constitutes sales in this state.

6. Mixed Intangible. Same facts as Example 5, except that the license agreement specifies separate fees to be paid for the right to produce the motor scooters and for the right to sell the scooters by marketing the fact that the scooters were manufactured using the special technology. The licensing agreement constitutes both the license of a marketing intangible and the license of a non-marketing intangible. Assuming that the separately stated fees are reasonable, the Franchise Tax Board will: (1) attribute no part of the licensing fee paid for the non-marketing intangible to this state, and (2) attribute 25% of the licensing fee paid for the marketing intangible to this state.
- (e) Sales from the sale, lease, rental, or licensing of real property are in this state if and to the extent the real property is located in this state.
  - (f) Sales from the rental, lease, or licensing of tangible personal property are in this state if and to the extent the tangible personal property is located in this state.
    - (1) Example. Railroad Corp is the owner of 10 railroad cars. During the year, the total of the days each railroad car was present in this state was 50 days. The receipts attributable to the use of each of the railroad cars in this state are a separate item of income and shall be determined as follows:
 
$$\frac{(10 \times 50 =) 500 \times \text{Total Receipts}}{3650 (365 \times 10)} = \text{Receipts Attributable to This State}$$
  - (g) Special Rules.
    - (1) In assigning sales to the sales factor numerator pursuant to Revenue and Taxation Code section 25136, the Franchise Tax Board shall consider the effort and expense required to obtain the necessary information, as well as the resources of the taxpayer seeking to obtain this information, and may accept a reasonable approximation when appropriate, such as when the necessary data of a smaller business cannot be reasonably developed from financial records maintained in the regular course of business.
      - (A) Example. Small Corp, a corporation located in this state, provides limited bookkeeping services to clients both within and outside this state. Some clients have several operations among various states. For the past ten (10) years, Small Corp's only records for the sales of these services have consisted of invoices with the billing address for the client. Small Corp's records have been consistently maintained in this manner. If the FTB determines that Small Corp cannot determine, pursuant to financial records maintained in the regular course of its business, the location where the benefit of the services it performs are received under the rules in this regulation, then Small Corp's sales of services will be assigned to this state

utilizing the billing address data maintained by the taxpayer. Small Corp will not be required to alter its recordkeeping method for purposes of this regulation.

- (2) To determine the customer's or licensee's use of intangible property in this state under subsection (d)(2)(A) 2. for marketing intangibles, factors that may be considered include the number of licensed sites in each state, the volume of property manufactured, produced or sold pursuant to the arrangement at locations in this state, or other data including population that reflects the relative usage of the intangible property in this state.
- (3) The following special rules shall apply in determining the method of reasonable approximation of the location of the market for the benefit of the services or the location of the use of the intangible property:
  - (A) Once a taxpayer has utilized a reasonable approximation method to determine the location of the market for the benefit of the services or the location of the use of the intangible property, then the taxpayer must continue to utilize that method in subsequent tax years. A change to a different method of reasonable approximation may not be made without the permission of and on such conditions as the Franchise Tax Board may prescribe.
  - (B) The method of reasonable approximation shall reasonably relate to the income of the taxpayer. For example, if the taxpayer includes in its reasonable approximation methodology countries which are identified in its contracts or its books and records maintained in the normal course of business but for which no sales are made during the taxable years at issue, then the reasonable approximation methodology being used by the taxpayer does not reasonably relate to the income of the taxpayer.
- (4) The sales factor provisions set forth in Regulation sections 25137 through 25137-14 are hereby incorporated by reference, with the following modifications. For taxable years beginning on and after January 1, 2011:
  - (A) All references to RTC section and CCR section 25136 shall refer to RTC section and CCR section 25136 as they are operative beginning on and after January 1, 2011.
  - (B) Regulation section 25137(c)(1)(C) [Special Rules. Sales Factor] shall not be applicable.
  - (C) The provisions in Regulation section 25137-3 [Franchisors] that relate to the taxpayer not being taxable in a state shall not be applicable.

- (D) The provisions in Regulation section 25137-4.2 [Banks and Financials] that relate to income-producing activity and costs of performance, and throwback, shall not be applicable.
- (E) The provisions in Regulation section 25137-12 [Print Media] that relate to a taxpayer not being taxable in another state and the sale's inclusion in the sales factor numerator if the property had been shipped from this state, shall not be applicable.

Note: Authority cited: Section 19503, Revenue and Taxation Code.  
Reference cited: Section 25136, Revenue and Taxation Code.